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FISCAL IMPACT STATEMENT

LS 7415 | **NOTE PREPARED:** Feb 4, 2015
BILL NUMBER: SB 438 | **BILL AMENDED:**

SUBJECT: State and Local Tax Issues.

FIRST AUTHOR: Sen. Hershman | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: The bill contains the following provisions:

Administrative Procedures: It codifies the attorney-client and deliberative process privileges.

Definition of Temporary Storage: It specifies that the definition of "storage" for purposes of the Use Tax does not include temporary storage of property for not more than 60 days for the purpose of the subsequent use of the property solely outside Indiana.

Sales Tax Refunds: It removes the 36 month rolling time limit on filing refund claims for utility purchases exempt from Sales and Use Tax.

Sales Tax Exemption - Medical Purchases: The bill amends the Sales Tax exemption for medical equipment, supplies, and devices to: (1) restate the application of the Sales Tax exemption for medical equipment, supplies, and devices; and (2) provide a Sales Tax exemption for food, food ingredients, and dietary supplements that are sold by a licensed practitioner or pharmacist. It amends the Sales Tax exemption for drugs, insulin, oxygen, blood, or blood plasma to restate the application of the Sales Tax exemption. It repeals the Sales Tax exemption for food and food ingredients prescribed as medically necessary by a physician.

Sales Tax Exemption - Research and Development: It amends the definition of "research and development activities" for purposes of the Sales Tax exemption for research and development equipment and property.

Sales Tax Exemption - Recycling: It eliminates the double direct test currently applied in the Sales Tax exemption for recycling machinery, tools, and equipment.

Retail Merchant Certificates: It provides guidance on when a retail merchant's certificate may be revoked.

Notification Requirements: It establishes standards governing the date by which a taxpayer must notify the Department of State Revenue (DOR) of a modification of a taxpayer's federal income tax return or tax liability for a taxable year.

Withholding Tax Filings: It requires an employer to file annual withholding tax reports (Form WH-3) not later than 31 days after the end of the calendar year.

Income Tax Refunds: It removes the two-year time limitation for refund of employment tax withholdings.

Research Expense Credit: It provides that "base amount" and "qualified research expense" for purposes of the state Research Expense Credit have the same meaning as those terms are defined under the Internal Revenue Code (IRC). It specifies that the federal research and development credit used for purposes of calculation of the Indiana Research Expense Credit is the same as the federal research and development credit allowed under the IRC.

Indiana Earned Income Tax Credit: It specifies that the federal Earned Income Tax Credit (EITC) used for purposes of calculating the Indiana EITC is the same as the federal EITC allowed under the IRC. It also removes outdated references to earned income tax advance payments.

Special Fuel Tax: It amends the Special Fuel Tax law to specify that the tax applies to biodiesel produced at a biodiesel manufacturing plant located in Indiana. It defines "biodiesel manufacturing plant" as a facility or operation located in Indiana that manufactures or produces biodiesel.

Cigarette Tax: It eliminates the ability to purchase Cigarette Tax stamps using a letter of credit.

Motor Carriers: It permits the DOR to deny an application for a motor carrier in certain situations.

Income Tax Filing Extensions: It provides that, if a person is allowed an extension of time by the Internal Revenue Service to file a federal income tax return, the corresponding due dates for the person's Indiana Income Tax returns are automatically extended for the same period as the federal extension.

Tax Warrants: It provides that a tax judgment may be released and a tax warrant expunged if the Commissioner of the DOR determines that the release of the tax judgment and the expungement of the tax warrant are in the best interest of the state.

Protest Procedures: It aligns the administrative procedures for protesting refund denials and proposed assessments.

Interest Application: It provides that the interest required to be paid on an overpayment of tax begins to accrue: (1) on the date the tax was due; or (2) the date the tax was paid; whichever is later. It provides that the interest rate that applies to an excess tax payment is the same as the interest rate established by the Commissioner of the DOR for failure to file a return. The bill provides that, in the case of a refund claim exceeding $10,000, the interest rate that applies to an excess tax payment is the same as the interest rate as computed on the return of state investments.

Commercial Motor Vehicle Fee: It provides that fees paid for the registration of commercial motor vehicles and collected by the DOR must be deposited in the Motor Carrier Regulation Fund.

Captive Insurer Definition: It amends the definition of "captive insurer" for insurance regulation and taxation purposes.

Wheel Tax Collection Fee: It provides that the DOR may charge a fee to a vehicle owner for collecting the Wheel Tax. It specifies that the fees collected must be deposited in the Motor Carrier Regulation Fund.

Tax Court: It changes the Tax Court's standard of review of DOR decisions.

Technical/Conforming Changes: It also makes technical corrections and conforming amendments.

Effective Date: July 1, 2015.

Explanation of State Expenditures: *Department of Insurance (DOI):* The change in the definition of captive insurers for the purposes of tax filings are within the DOI's routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

(Revised) *Department of State Revenue (DOR):* The bill contains multiple provisions that affect the operations of the DOR. The DOR will incur additional expenses to revise forms, update instructions, and modify software applications. However, the bill also establishes identical procedures for protesting both refund denials and proposed assessments. Aligning the procedures will improve DOR's efficiency in resolving protests. In addition, the DOR will realize administrative cost savings in not having to generate Special Fuel Tax refunds for biodiesel exported out of state. The DOR should be able to implement the provisions within the bill with their current level of staffing and resources.

Tax Court: The bill changes the Tax Court's standard of review. The bill states that the Tax Court will grant deference to the DOR's findings of fact and interpretation of statute of rule. This provision will have an indeterminable impact on Tax Court decisions.

All State Agencies: The bill establishes protections for privileged communications of state officials and agencies. It states that decision making activities and information are protected by a deliberative process privilege and are not subject to discovery except as provided by statute. The deliberative process privilege applies to documents, testimony, and any other deliberative communications. This provision has no fiscal impact.

Explanation of State Revenues: (Revised) *Summary -* The table below summarizes the estimated impact of provisions in the bill. (Provisions having no fiscal impact are excluded from the table.) Following the table are brief explanations of the provisions and potential revenue impacts. The provisions are categorized based on whether they are: (1) likely to increase state revenue, (2) likely to have no fiscal impact, or (3) likely to decrease state revenue.

Provision	Estimated Impact ($ in millions)	
	FY 2016	FY 2017
Sales Tax Exemption - Medical Purchases	*	*
Sales Tax Exemption - Recycling	$0.2	$0.2
Definition of Temporary Storage	*	*
Withholding Tax Filings	*	*
Captive Insurers	*	*
Indiana Earned Income Tax Credit	($12.8 - $15.8)	($12.8 - $15.8)
Research Expense Credit	($1.0 - $5.0)	($1.0 - $5.0)
Income Tax Refunds	($1.0 - $1.8)	($1.0 - $1.8)
Sales Tax Refunds	(*)	(*)
Interest Application	(*)	(*)
Tax Warrants	(*)	(*)
Total	**($14.6 - $22.4)**	**($14.6 - $22.4)**

* Indeterminable fiscal impact.

Likely to Increase State Revenue -

Sales Tax Exemption - Medical Purchases: The bill restates Sales Tax exemptions for medical purchases by patients, including equipment, devices, supplies, and drugs that are prescribed by a licensed practitioner. It also restates exemptions for purchases of drugs and certain other items by licensed practitioners or health care facilities for direct consumption in treating patients. The bill does not substantially change any of the current Sales Tax exemptions for medical purchases. Data are not available to provide a specific estimate, but it is expected that the changes will result in a Sales Tax revenue increase that is likely to be small.

Sales Tax Exemption - Recycling: The bill eliminates the double direct test currently applied in the Sales Tax exemption for recycling machinery, tools, and equipment. This provision would not significantly change the exemptions provided to taxpayers engaged in the business of recycling. However, the bill also removes collection from the definition of "processing of recycling materials" for the purposes of this exemption, so motor vehicles and other items used in the collection of recycling materials will be taxable. Data are not available to provide a specific estimate of the revenue increase from this definition change, but it is possible to establish a benchmark. If 50 recycling trucks are purchased each year on a statewide basis at a cost of $50,000 each, this provision could increase Sales Tax revenue by $0.2 M annually.

Definition of Temporary Storage: This provision clarifies current law, which allows an exemption from Use Tax for property that is stored in Indiana and subsequently transported out of the state. The bill provides that this exemption only applies if the property is stored in Indiana for not more than 60 days. This provision could potentially cause a small increase in revenue through audit and voluntary compliance because it clearly defines the time period for temporary storage for businesses that store items for shipment to other states. The actual Sales Tax revenue increase is indeterminable but likely to be small.

Withholding Tax Filings: The bill requires an employer to file annual withholding tax reports (Form WH-3) no later than 31 days after the end of the calendar year. The DOR currently requires employers to file form WH-3 before the last day in February. This will aid the DOR in its compliance activities. The actual Income Tax revenue increase is indeterminable, but it is likely to be small.

Captive Insurers: This bill expands the definition of captive insurers for the purposes of tax filings. Currently captive insurers are required to remit $2,500 per year to the DOI to write business in the state. The DOI reports that for CY 2014, a total of 33 captive insurers registered with the DOI, resulting in $82,500 in revenue. By expanding the definition of captive insurers, this bill could increase revenue the state receives by an indeterminable amount beginning in FY 2016.

Likely to Have No Fiscal Impact -

(Revised) *Special Fuel Tax*: The bill provides that biodiesel fuel that is manufactured in Indiana and shipped out of state is exempt from the Special Fuel Tax. Under current law, the taxpayer must claim a refund for the tax paid on biodiesel exported out of state. Currently, biodiesel that is manufactured in Indiana and exported generates a monthly refund between $0.75 M and $1 M.

Sales Tax Exemption - Research and Development: The bill clarifies the definition of what is considered "research and development activities" and "research and development property" for the purpose of the Sales Tax exemption for property used in research and development. This provision puts into statute the requirements that the DOR currently uses to determine eligibility for the exemption, so it would not have a significant impact on revenue.

Retail Merchant Certificates and Motor Carrier Applications: The bill clarifies under what circumstances the DOR may revoke a retail merchant's certificate or deny a motor carrier application. This provision could potentially result in the revocation of additional certificates and reduce the number of motor carriers. However, it is not likely to have a significant impact on state revenue.

Income Tax Filing Extensions: If the Internal Revenue Service (IRS) grants an entity a filing extension for their federal income tax return, the due dates of the entity's corresponding Indiana Income Tax return are automatically extended for the same period. Current law gives the Indiana taxpayer an additional 30 days beyond the date provided by the IRS.

Notification Requirements: The bill clarifies what constitutes a modification of a taxpayer's federal income tax return or tax liability. It also changes the time in which a financial institutions taxpayer must file an amended Indiana return if they amended a federal income tax return. The notification deadline is extended from 120 to 180 days after the taxpayer filed their amended return.

Cigarette Tax: The bill eliminates the ability to purchase cigarette tax stamps using a letter of credit. Distributors would be required to purchase cigarette tax stamps with cash or file a bond in an amount that is at least the price of the stamps. This provision would not have a significant impact on revenue, other than to prevent the state from losing Cigarette Tax revenue from a distributor that defaults on a letter of credit.

Indiana Earned Income Tax Credit: Eliminating the references to advanced EITC payments will have no fiscal impact. Federal legislation signed into law August of 2010 repealed the advanced EITC effective December 31, 2010.

Likely to Decrease State Revenue -

Commercial Motor Vehicle Fee and Wheel Tax Collection Fee: The DOR collects the fees paid for the registration of commercial motor vehicles as well as fees charged to a vehicle owner for collecting the Wheel Tax. The bill deposits those fees collected by the DOR into the Motor Carrier Regulation Fund (MCRF). As written, the bill deposits all revenues generated from collection of both the International Registration Plan and base plate registrations collected by DOR into the Motor Carrier Regulation Fund. Most of these revenues currently go the Motor Vehicle Highway Account, Highway Road & Street Fund, Crossroads 2000 Fund, and to the Bureau of Motor Vehicles.

These provisions provide a transfer of approximately $99 M in funds to the MCRF. Any balance in the MCRF that exceeds $0.5 M at the end of the fiscal year will be transferred to the Motor Vehicle Highway Account. Assuming the DOR spends $2.5 M for operations throughout the year, this provision will result in a net decrease of $3 M in funds that would have been deposited into various vehicle highway accounts. A preliminary estimate shows that the State Highway Fund will lose $1.5 M, Crossroads 2000 Fund will lose $0.1 M, and the Bureau of Motor Vehicles will lose $2.4 M in revenues.

Indiana Earned Income Tax Credit (EITC): The bill modifies the computation of the Indiana EITC. Currently, the credit equals 9% of the federal EITC as it existed before amended by the federal *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.* The bill updates the federal EITC reference to the date the Internal Revenue Code (IRC) is referenced in Indiana statute. This will increase the credit provided to individuals and reduce state General Fund revenue by the amount of credits claimed. The revenue impact will likely begin in FY 2016 when individuals file their tax year 2015 returns. This provision will likely reduce state revenue by about $12.8 M to $15.8 M per year. Future revenue losses will depend on the number of claimants, federal law, and whether the reference in Indiana statute to the IRC in effect on a particular date is updated to include such legislation.

Research Expense Credit: Changing certain definitions pertaining to the state Research Expense Credit is estimated to decrease revenue to the state General Fund by an estimated $1M to $5M annually. The Research Expense Credit may be claimed by Corporate AGI taxpayers and Individual AGI taxpayers.

The Research Expense Credit is based on the federal R&D tax credit. Under current law, the Research Expense Credit uses the IRC definition for "Qualified Research Expense" (QRE) and "Base Amount" as it was in effect on January 1, 2001. These definitions are used in calculating the amount of Research Expense Credit that could be claimed by a taxpayer. The bill updates the federal R&D tax credit reference to the date the Internal Revenue Code (IRC) is referenced in Indiana statute. Under current Indiana law, the QRE can be categorized as: (1) wages of employees engaging in qualified research, (2) supplies used for qualified research, and (3) a portion of contract research expenses paid to outside entities to perform qualified research.

The change in the bill will allow 100% (instead of 65% under current Indiana law) of the R&D expenses paid by the taxpayer to eligible small businesses, universities, and federal laboratories for qualified research which is energy research, to be qualified research expenses for the Indiana credit. Updating the definition of "Base

Amount” will not have any impact on the amount of claims.

Income Tax Refunds: The bill increases the statute of limitations for refund claims requested by taxpayers with wages withheld from two to three years. The provision is effective beginning in FY 2016. The provision is estimated to decrease revenue into the state General Fund by approximately $1.0 M to $1.8 M annually.

Sales Tax Refunds: The bill removes the 36 month time limit for taxpayers to claim the Sales Tax exemption for utilities purchased for direct consumption in the direct production of other tangible personal property. This provision could potentially decrease Sales Tax revenue to the extent that taxpayers claim additional exemptions for purchases that occur more than 36 months before the exemption is claimed. However, any decrease in revenue is likely to be small, as the majority of taxpayers would likely continue to claim the exemption within 36 months.

Interest Application: The bill alters the dates of when interest accrues on an overpayment. The bill states that interest begins to accrue on the later of either the date the tax was paid, or the date the payment was due. However, no interest is due for any time before the corresponding return is filed. This provision will result in taxpayers accruing more interest on overpayments. The bill also lowers the applicable interest rate for refund claims exceeding $10,000. The interest rate for refund claims over $10,000 will be two percentage points lower than the current interest rate. That will reduce the amount of interest paid on large refunds. Together, these provisions will likely result in an indeterminable decrease in state revenue.

Tax Warrants: This bill establishes that the Commissioner of the DOR may expunge a tax warrant if it is in the best interest of the state. As the DOR currently expunges very few tax warrants, the expansion of the expungement circumstances proposed by the legislation may cause some small, but unmeasurable, fiscal impact.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) *Local Highway Departments:* Local units that receive distributions from the Motor Vehicle Highway Account and Highway Road and Street Account will be affected by the bill. From the changes in the Motor Carrier fee collections, local units will lose approximately $1.3 M in revenues.

State Agencies Affected: Department of Insurance; Department of State Revenue, Indiana Department of Transportation, Bureau of Motor Vehicles; All executive and administrative agencies.

Local Agencies Affected: Local units who receive distributions from the Motor Vehicle Highway Account and Local Road & Street Account.

Information Sources: LSA Income Tax Database; Chad Ranney, DOR; Jim Poe, DOR, jpoe@dor.in.gov; *The Education Jobs and Medicaid Assistance Act of 2010;* Internal Revenue Service, Statistics of Income; Randy Boone, DOR, rboone@dor.in.gov; Department of Revenue, WH-3 Withholding Tax Electronic Filing, http://www.in.gov/dor/4455.htm; Internal Revenue Code, 26 U.S. Code § 32 - Earned Income; Internal Revenue Code, 26 U.S. Code § 41 - Credit for increasing research activities.

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